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April 13, 2004

By Electronic Filing

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th St., SW
Washington, D.C. 20554

Re: Notice of *Ex Parte* Meeting in *CC Docket Nos. 93-193; 94-65 and 94-157*

Dear Ms. Dortch:

On April 12, 2004, Patrick Merrick of AT&T Corp. and I met with William Maher, Tamara Preiss, Margaret Dailey, and Aaron Goldschmidt to discuss issues raised in the above-captioned dockets.

In *Southwestern Bell Telephone Company* v. *FCC*, 28 F.3d 165 (D.C. Cir. 1994), the Court reversed a Commission decision involving the rate impact of other post retirement benefits ("OPEBs") on the "ground that the Commission arbitrarily and capriciously disregarded its own rule." *Id.* at 167. AT&T noted that the Commission would have to commit that very same error to accept the positions that SBC and Verizon urge in this proceeding. Commission rules in place at the time of the 1996 tariff filings at issue in the "RAO 20" dispute, for example, expressly and unambiguously prohibited the extraordinary exogenous cost increases through which SBC, Verizon and the other Bells attempted to transform retroactive rate base restatements into prospective rate increases. *See* 47 C.F.R. § 61.45 (1995); First Report and Order, *Price Cap Performance Review for Local Exchange Carriers,* 10 FCC Rcd. 8961, ¶¶ 292, 307 (1995); AT&T March 15, 2004 *Ex Parte Letter*.[1] The Bells never come to grips with these rules and would have the Commission simply disregard them. Although the Bells' own tariff filings expressly labeled their rate-base-restatement rate increases as exogenous cost increases, they

[1] Likewise, as AT&T showed in its March 15, 2004 *Ex Parte*, two separate Commission rules in the relevant time period expressly precluded Bell Atlantic's attempt to seek exogenous cost treatment of OPEB amounts purportedly incurred prior to January 1, 1993.

now urge the Commission to pretend that they were something else entirely. But there is *no* component of the section 61.45 PCI formula in place at the time that conceivably authorized such rate increases (for the 1992 and 1993 rate base restatement).

Lacking any explanation how their tariff filings can be squared with the Part 61 rules that applied to those filings, the Bells have throughout this proceeding attempted to focus the Commission's attention on the Part 65 rate base rules. They claim that the Commission has no choice but to endorse the rate base restatements they made as fully consistent with those rules. As AT&T has previously explained, even if that were true, it could not solve the Bells' failure to demonstrate that they qualified under Part 61 for *rate* increases at issue here. In fact, however, the Bells' rate base claim is wrong as well.

The Bells take an extreme and untenable position that has no basis in law and that, if adopted, would tie the Commission's hands and prevent it from carrying out its core statutory obligation to ensure that dominant carrier rates and practices are just and reasonable. They contend that Part 65 of the Commission's rules (47 C.F.R. §§ 65.800-830) contains the exclusive list of items that must be included and excluded from the rate base calculations and that the Commission has *no authority* in tariff investigations to address the proper rate base treatment of new assets or liabilities or other new circumstances that are not expressly addressed by the rules and were not even contemplated when the rules were promulgated. Under the Bells' view, the Commission's rules commanded them to do "X" and the Commission cannot in this tariff investigation decide that they were instead required to do "not X."

The Bells read far too much into the rate base rules. 47 C.F.R. § 65.830 simply lists certain items that "shall be deducted from the interstate rate base." There is no indication in the rules or any Commission order that the items that appear in § 65.830 at any given time are meant to be the *exclusive* list for all time, never to be expanded or contracted except through prospective rulemakings outside of tariff investigations, of items the Commission may require a carrier to deduct from its rate base for purposes of rate of return calculations. Rule 65.830 reflects the need to reduce the rate base on which investor returns are determined to reflect the fact that some portion of the firm's assets has been funded with capital supplied from sources *other* than investors, and that investors earn returns on the capital *they* supply. *All* such "zero cost" sources of capital must be deducted if returns are to be properly calculated and, of course, not even the most prescient regulator could hope to anticipate all of the myriad forms that such zero cost capital might take. The categories expressly listed in section 65.830 at any given time thus merely reflect the ones that have come to the Commission's attention to that point.

That is why the Commission has, in fact, *never* read the Part 65 list of inclusions and deductions to be so rigidly exclusive as to preclude case-by-case consideration of the appropriateness of particular costs that have not yet been specifically addressed at the time a tariff dispute arises. For example, in 1995 the Commission found that Ameritech had been improperly including an equity component in its cash working capital allowance, which is included in the rate base. Ameritech contended that "because the equity component was not specifically listed among the exclusions [in the Part 65 rules], it can be included in cash working

capital calculations pending further, more specific pronouncements by the Commission."[2] Ameritech argued that "the applicable rule, Section 65.820(d), continues to be worded in a way that permits the inclusion of an equity component in the development of the cash working capital allowance."[3] The Commission rejected that argument, and stated that "even if the Commission did not specifically exclude equity from cash working capital in the [original rules], the omission in the order cannot logically or legally be relied upon to justify including equity in earlier calculations [*i.e.*, calculations prior to the Commission's later order clarifying that equity was to be excluded]."[4]

There was nothing remarkable about that ruling. Rather, it is well settled that in tariff investigations, the Commission can address new circumstances in a manner that is consistent with the public interest and Commission policy even if its existing rules do not expressly prohibit a disputed new practice. "[A] tariff investigation is a rulemaking of particular applicability under the APA,"[5] in which "[t]he Commission routinely makes significant policy and methodological decisions based on the records developed in tariff investigations and such decisions do not violate the notice and comment requirements of the [APA]."[6] Accordingly, the Commission can in *this* tariff investigation reject the Bells' proposed rate base restatements to reflect the reality that the Bells' practice with regard to OPEBs was simply not contemplated or addressed by rate base rules. That is not, as the Bells wrongly suggest, tantamount to an unjustifiable about-face on the proper rate base treatment of OPEBs, but the filling of a clear gap in those rules, which is standard agency fare. In so doing, the Commission would not be interpreting its rules in a way that "arbitrarily and capriciously disregarded" the text of those rules as the Court found in *Southwestern Bell,* but forthrightly, reasonably and with fair notice construing and supplementing those rules to address a new practice. Indeed, the road to reversal here is the one urged by SBC and Verizon of mechanically applying the rate base rules without regard to context the rules' core purposes. *See*, *e.g.*, *C.F. Communications* v. *FCC*, 128 F.3d 735, 740-41 (D.C.Cir. 1997) ("The Commission simply – and, we think, unreasonably – ignored context and stated that we must apply our rules as they are now codified….The Commission put on blinders after it found that CFC did not meet its definition of public telephone, not acknowledging that the definition had been adopted in a different context"); *WAIT Radio* v. FCC, 418 F.2d 1153, 1157 (D.C. Cir. 1969) ("That an agency may discharge it responsibilities by

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[2] *See* Order to Show Cause, *Ameritech Operating Companies*, 10 FCC Rcd. 5606, Appendix A ¶ 6 (1995).

[3] *Id*. ¶ 5.

[4] *Id.* ¶ 6.

[5] *See, e.g., See, e.g.,* Memorandum Opinion and Order, *Tariffs Implementing Access Charge Reform*, 13 FCC Rcd. 14683, ¶ 81 (1998) ("*Access Reform Tariff Order*"); Memorandum Opinion and Order, *Implementation of Special Access Tariffs of Local Exchange Carriers*, 5 FCC Rcd. 4861 (1990); 5 U.S.C. § 551(4).

[6] *Access Reform Tariff Order* ¶ 81.

promulgating rules of general application which, in the overall perspective, established the 'public interest' for a broad range of situations, does not relieve it of an obligation to seek out the public interest in particular, individualized cases").

If the Commission were constrained to deal with each new gray or unanticipated area only in a rulemaking initiated after a tariff dispute arose and with rules that could apply only to *subsequent* disputes, as the Bells' contend, the Bells could, with impunity, use all new unjust and unreasonable practices that Commission rules have failed to prophesy to raise rates in at least one annual tariff filing. That has never been – and could not rationally be – the law. Contrary to the Bells claims, section 65.830 of the Commission's rules is not an exclusive list of items that must be deducted from the rate base, but is a list of items that can be augmented to account for new circumstances in tariff investigation proceedings.

Consistent with the Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the proceedings.

Respectfully submitted,

/s/ David L. Lawson

David L. Lawson

cc: Laurel Bergold
Margaret Dailey
Sharon Diskin
Aaron Goldschmidt
Jane Jackson
William Maher
Tamara Preiss
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